

VZCZCXRO0452
RR RUEHCHI RUEHCN RUEHDT RUEHHM
DE RUEHJS #0086/01 2000624
ZNR UUUUU ZZH
R 180624Z JUL 08
FM AMCONSUL SURABAYA
TO RUEHC/SECSTATE WASHDC 0257
RUEHJA/AMEMBASSY JAKARTA 0243
INFO RUEHRC/USDA FAS WASHDC
RUEHJS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS
RUEHWL/AMEMBASSY WELLINGTON 0135
RUEHBY/AMEMBASSY CANBERRA 0135
RHHMUNA/HQ USPACOM HONOLULU HI
RUEHJS/AMCONSUL SURABAYA 0262

UNCLAS SECTION 01 OF 02 SURABAYA 000086

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SIPDIS

DEPT FOR EAP/MTS
USDA/FAS/OA FOR YOST, MILLER, JACKSON
USDA/FAS/OCRA FOR CRIKER, HIGGISTON, RADLER
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E.O. 12958: N/A

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SUBJECT: EASTERN INDONESIA: RISING PRICES PUSH INDONESIANS TO REDUCE
WHEAT CONSUMPTION

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Accordingly.

1. (SBU) Summary: Over the past three months, Eastern Indonesia's flour mills have witnessed a dramatic shift in domestic consumption of wheat products as food and energy prices rise. During recent visits by ConGen Surabaya Principal Officer to two of the world's largest flour mills, Bogosari in Surabaya and Eastern Pearl in Makassar, company officials described a rapid shift in consumer demand to lower-cost and lower-quality flour and an increase in flour smuggling. The cheaper flour has lower nutritional value, raising concerns about malnutrition rates. While both companies expect wheat demand to rebound and see many future market opportunities, in the short term they are looking for strategies to reduce costs and maintain current demand. End Summary.

Demand Shift

2. (SBU) The Bogosari Flour Mill in Surabaya, East Java, is the world's second-largest flour mill. The mill has a capacity to produce about 4,800 tons of flour a day, but it only produces about 60 to 70% of that capacity. The Eastern Pearl Mill in Makassar, South Sulawesi, is the world's fourth largest mill. Both Bogosari and Eastern Pearl reported a shift in the domestic market's wheat preferences over the past three months in the face of rising fuel and food prices. While total production has remained steady overall, consumers are demanding cheaper, lower quality flour. (Note: Both mills are owned by the Salim Group, a huge Indonesian agribusiness concern).

3. (SBU) The demand for high-end flour has remained steady; medium-quality flour however is falling out of favor. Four months ago, production at both mills was divided 20% high quality, 40% medium quality, and 40% low quality. Today, low quality flour makes up 60% of both mills' production. The companies attribute this shift in consumer preference to higher food and fuel prices that have made medium-quality flour unaffordable, particularly in smaller towns and villages where the Rp. 10,000 (USD 1.00) difference between medium-quality and low-quality flour is significant.

Imports of U.S. Wheat Up

14. (SBU) Bogasari imports wheat from the U.S., Canada, Australia, Turkey, Dubai, and to some extent China and India. Bogasari imports of U.S. wheat for the first six months of 2008 (160,000 tons) had already surpassed the total volume of U.S. wheat purchased in 2007 (110,000 tons). Bogasari managers complained that smuggled wheat and flour from Turkey was undercutting Indonesian mills and represented a longer term health risk for Indonesia. Smuggled Turkish flour has none of the vitamin and mineral additives usually required by the Indonesian government. The government has reduced the import duty tax on wheat to 0% to help address millers' concerns. Bogasari estimated, however, that 60% of imported flour is smuggled. As Eastern Pearl is partially Australian owned, the majority of its wheat imports are Australian.

Infrastructure Constraints

15. (SBU) Both Bogasari and Eastern Pearl said that infrastructure constraints were not as big a problem for them as for other companies, although their transportation costs have increased 20-25%. Eastern Pearl owns a fleet of ships to transport its flour throughout Indonesia. Bogasari relies on distribution companies for delivery, so increased transportation costs are borne by the customer. Both companies maintain generator capacity in order to avoid rolling blackouts that have affected many area companies. Eastern Pearl said it had reached agreement with the national electricity monopoly to reduce energy consumption during peak demand times in order to ensure sufficient supply. Bogasari noted that their proximity to a state electrical power plant helped the company avoid blackouts.

Plenty of Room for Growth

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16. (SBU) Bogasari management in particular expressed optimism that the Indonesian flour market would continue to grow in step with Indonesia's economy. Indonesia's annual consumption of wheat is only 14 kg/capita, whereas neighboring Singapore and Malaysia, with their growing middle classes, consume 30 kg/capita. But given the size of Indonesia's population, the cost of expanding the facilities to produce even an additional 1 kg/capita would be very high. That said, two new flour mills are planned for West Java and one is planned for Medan. Bogasari management believes that low purchasing power is the flour industry's main obstacle to growth.

MCCLELLAND